

## Business Studies



### Section III

**20 marks**

**Attempt Question 25**

**Allow about 35 minutes for this section**

Answer the question in the Section III Writing Booklet. Extra writing booklets are available.

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Your answer will be assessed on how well you:

- demonstrate knowledge and understanding relevant to the question
  - communicate using relevant business terminology and concepts
  - present a sustained, logical and cohesive response in the form of a business report
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### Question 25 (20 marks)

Barry really enjoys being a carpenter. He has worked in a large business for 10 years and has deep experience and skills in the profession.

He really wants to start his own business specialising in making customised old-style wooden furniture but feels unsure about where to start.

He has sold a few pieces of furniture online through private sales and has received excellent feedback. His business will require a large space and large pieces of technology. Barry is excellent at making furniture, however, has limited experience in the management of a business.

You have been hired to write a business report for Barry.

In your report, you should:

- Outline the role of a breakeven analysis in business planning.
- Discuss TWO marketing strategies Barry could use to build customer awareness.
- Evaluate the importance of finance and accounting for business success

**End of paper**

## Section III or Section IV Response

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Question Number

1.0 Executive Summary

Barry is keen to convert his deep experience as a carpenter into a business. He is uncertain about the process of building and managing a business. His individual furniture pieces are proving popular, but to scale production into a viable business will require a large financial commitment to purchase necessary space and technology. This report will outline how a break-even analysis can be used in business planning, provide advantages and disadvantages of promotional and pricing strategies, and evaluate as critically important the role of finance and accounting for Barry's business success.

2.0 Break-even Analysis

Break-even analysis is a forecasting tool used in business planning. It determines the number of sales required to cover all fixed and variable costs - for a business to not lose money, nor make any profit. The formula is:

$$\text{Quantity (Q)} = \frac{\text{Total Fixed Costs}}{\text{Unit Price} - \text{variable cost per unit}}$$



This information would be incredibly useful for Barry to see if the business idea is viable. He would need to research + estimate fixed costs (rent) and variable costs (utilities, materials), and allocate prices to various units. One clear challenge for Barry in using this tool, however, is the non-repeatable, customised pieces he produces - which will invariably have different costs. Nevertheless, a break-even analysis will provide an estimation of the number of units Barry must sell to avoid losing money. If this quantity of sales is not possible (if the market is too small), this information will guide Barry to not commence the business.

### 3.0 Marketing Strategies

Marketing is a set of activities to plan, promote, price and distribute products or services to maximise sales. Barry could deploy promotional and pricing strategies to position his business and generate customer awareness.

#### 3.1 Promotional Strategies

Promotion involves co-ordinated activities to

generate customer awareness of a product offering. Barry should utilise advertising to generate customer awareness and demand.

- Advantages: placing paid messages in strategic locations where his target market would drive interest and generate leads and sales. Magazines like 'House and Garden', for example, would be ideal for Barry to showcase some of his creations.

Strategic placement of social media post that direct traffic to a website would also be an excellent tool to build awareness.

- Disadvantages: Advertising is costly and would add to the significant expenses that Barry must pay to establish his business. The advert (in a magazine, for example) would need to be professionally created, and the full page ad would be expensive. Social media posts are highly likely to be scrolled past - with very low click rates and follow-through rates.

### 3.1 Pricing Strategies

The exchange value attributed to a good or service helps position and communicate the value of a product or service offering. There

are a number of methods through which Barry could set his prices - cost-plus, market-based, and competition-based pricing.

- **Advantages:** market-based pricing will allow Barry to set prices that are achievable for his target market. Customers interested in custom furniture are typically not price sensitive, meaning Barry could use premium pricing for his output. This will lift profit margins per sale, and will also create a strong sense of quality and status of his furniture.

- **Disadvantages:** using premium pricing will create a barrier to many consumers - even within the target demographic. As Barry's business has no reputation, the premium price may result in lower initial sales, making the cash flow of an establishing business very tight. This will impact Barry's ability to pay for other obligations as they fall due.

#### 4.0 Finance and Accounting

Finance refers to the type, cost and availability of sources of funds - equity and debt - to finance a business. Accounting refers to the systematic processes of recording financial

transactions to monitor and control a business' financial position and performance. Both of these are critically important in determining the success of a business.

#### 4.1 Finance

Business owners must choose an appropriate source of funds to establish their business, or to finance growth plans. Different sources of finance (equity or debt) hold different features and advantages - including cost, accessibility and flexibility. Selecting the right mix of sources is critical in securing the short and long term stability of a business. Barry will need large sums of capital to commence operations. The purchase (or leasing) of a large premises and all the capital equipment (machine technology) required to produce custom output will require a huge financial commitment. How Barry obtains this will be impactful on his business' success. For example, debt financing is accessible, but costly and can increase the chances of business failure, whereas equity is stable, but Barry would forsake a percentage of

ownership of his business. Furthermore, Barry must not fall prey to undue capitalisation when commencing the business. These financing decisions are critical in determining business success.

## 4.2 Accounting

The recording of all financial transactions on Cash Flow Statements, Income Statements, and Balance Sheets, is critically important for business owners to be fully aware of the performance and position of their firm. Without these processes, business owners are operating blindly, making decisions without a foundation in the actual situation of the business. Barry must learn these processes - or use an accountant, or accounting software like Xero to monitor the day to day situation of his business. Without continual monitoring, Barry would remain unaware of the relative success or failure (profit or loss?) of the business. This clearly demonstrates the enormous importance of accounting to business success.

## 5.0 Recommendations

- Barry should complete a break-even

analysis to determine the viability of the business idea

• Promotional activity will be costly but essential for the successful establishment of his business. Using premium, market-based pricing will align with his high quality output.

• Barry might be best to gain basic training in Finance and Accounting - or employ the services of an expert. While costly, the importance of these functions is too critical to ignore or get wrong.

If you require more space to answer Question 25, you may ask for an extra writing booklet.

If you have used an extra writing booklet for Question 25, tick here.

